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Economic restructuring in the NIS: The search for inspiration

For more than a decade now, the Newly Independent States and Eastern European countries have taken the highroad to economic transformation. In many aspects, this was a common pathway that, more than anything, pointed to the common problems that each of these countries was facing at the beginning of 1990s. Yet, this does not deny the uniqueness of each country and the varying degrees of success in economic restructuring, say, between the Baltic countries or the Visegrad Four and Kazakhstan or Ukraine. The "Industrial Restructuring in the NIS: The experience of the new EU Member States and the lessons learned" (INDEUNIS) project implemented by ICPS over the last three years was an evaluation of the results of economic development among NIS and their further prospects. Here are some of the highlights of this study

Pre-conditions for successful restructuring

The results of economic transformations in Eastern European countries that recently became members of the EU were more successful than those of the CIS. This refers to four stages of transformation that, one way or another, were inherent to all countries in this region:

1) geographic re-orientation in trading;
2) changes in the commodity breakdown of output and trade;
3) integration with European and other international markets;
4) the beginning of movement up the ladder of comparative advantage.

Most studies indicate that the CIS lagged behind the New EU Member States the most in the second and the fourth stages. For example, resources dominate exports in both Russia and Ukraine, while the actual high scientific potential of these countries did not lead to an increase in output and exports of hi-tech products. The majority of researchers agreed that the "primitivization" of industry and trade in the CIS was primarily the result of slow reforms and not of these countries' different initial positions.

Small inflows of foreign direct investment (FDI) to CIS countries are confirmation of their slow restructuring. Although investment has picked up in the region in recent years, despite slow reforms, the new EU Member States attract both more new FDI and more capital investment altogether. Among others, studies indicate that industrial integration with the help of FDI tended to lead to increased productivity, the introduction of new technologies and also an increase in exports. Favorable conditions are identical for both foreign and domestic investors, as there is a strong, independent judicial branch and a good system of corporate governance.

The relative success of reforms in EE countries can be explained by the influence of the European Union. The powerful stimulus of EU accession made it possible for these countries to quickly implement very unpopular, expensive and exhausting reforms. With no prospects for membership, Ukraine and other CIS countries have not had broad access to European markets, capital, management technology and financial support. CIS governments were unable to show why painful restructuring might be needed or to overcome resistance to reforms among various interest groups.

How might success be repeated?

The key issue debated by participants in this study was: how can CIS countries copy the way the new EU Member States undertook transformations? First, the prospects of EU accession remain very distant for CIS countries, even for Ukraine, which has followed a European integration strategy and has made the greatest progress towards EU membership. Some CIS countries are not considering the prospect of membership at all, such as, Russia, which is developing its own strategy of development and integration with other countries.

Second, there are no other alternatives to EU membership, so far, that could have

Table 1: Inward FDI stock per GDP, in percent

	1994	2004
Belarus	12	9
Estonia	31	79
Hungary	42	55
Latvia	22	30
Lithuania	14	26
Moldova	36	36
Poland	13	26
Romania	10	22
Russia	5	17
Slovakia	13	33
Ukraine	6	14

Source: WIIW FDI database

an equal impact on the transformation of a country. For example, accession to the World Trade Organization provides very weak incentives for consistent implementation of reforms, as the direct economic benefits of membership in this organization are fairly small. In addition, both Ukraine and Russia have largely already fulfilled most WTO requirements to applicants.

The Baltic countries provide an example of a development strategy without any external incentives at the beginning of 1990s. Before they had even signed agreements on eventual accession to the EU, which happened in 1995, these three countries implemented policies and reforms that they would have had to implement should the EU consent to their accession. The one-sided integration of these countries into Europe and their efforts to liberalize and set up new institutions prior to 1995 were not so effective in the Baltic countries as in other candidate countries at that time, but more effective than those implemented in CIS countries.

After choosing your strategy, stick to it!

CIS countries need to choose between two strategies for industrial restructuring. The first strategy, which was implemented by the new EU Member States, includes continuing liberalization, developing market institutions, and making modernization of transport and telecommunications infrastructure, and scientific research a state funding priority. The second strategy involves active state policy to support priority industrial sectors. Specifically, this would be by providing incentives for exports of hi-tech goods with the help of exemptions or using trade restrictions to support infant industries and to revive the sectors that have gone into decline.

Ukraine tried both strategies. However, it failed to carry either of them through, which has resulted in both successes and failures. The policy of active state intervention and support for certain manufacturing sectors has not guaranteed their successful development. On the contrary, it has frequently led to serious abuse and excessive public spending. Economic liberalization has also sometimes involved unreasonably high costs to the domestic economy and taxpayers because of the inappropriateness of existing institutions and delays in setting up new ones.

Demand for investment and the need for further economic integration at the company and sector levels can spur a search for the most effective formats for cooperation among countries. At the moment, Ukraine can already act as though it is a candidate for EU accession and begin to implement faster reforms among sectors and institutions, following EU standards. In addition, a new free trade area between Ukraine and the EU should make it possible to act on this supposition in the broadest manner.

The rapid growth of GDP that CIS countries have been demonstrating for some years now offers an illusion of progress in their reforms. This distracts the attention of politicians from structural problems in these economies and fosters the attitude that reforms can wait or that they are not even necessary. A favorable situation on external markets for fertilizers and steel products clearly gave Ukraine's economy a major jump-start. So far, even higher gas prices have not had a tangible negative impact on the country's energy-intensive and inefficient industries. Ukraine can either wait until the economy begins to feel this impact—or look for inspiration to those countries that have already achieved more. ■

INDEUNIS is an international research project coordinated by the Vienna Institute for International Economic Studies (WIIW) with the financial support of the European Commission. Participants include representatives of Austria, Belarus, Estonia, Finland, Hungary, Kazakhstan, Poland, Russia, and Ukraine. The issues under examination are experience with economic transformation, industrial restructuring and integration processes among both new EU Member States from Central and Eastern Europe and select Newly Independent States (Belarus, Russia, Ukraine, Moldova, and Kazakhstan). More than 50 analytical reports were prepared in the course of this project. You can see these reports on the project's website at http://indeunis.wiiw.ac.at/.

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Roundtable on the Ukraine-EU Free Trade Agreement held in Donetsk

As part of the "EU-Ukraine FTA: Analytical, methodological and informational support for negotiations" project, ICPS is organizing consultations regarding the future Free Trade Agreement between Ukraine and the European Union.

Together with the Ministry of Economy and the Donetsk Chamber of Commerce and Industry, ICPS held the roundtable called "The impact and prospects of a Free Trade Agreement between Ukraine and the European Union" in Donetsk on 26 November 2007.

The goal was to organize meaningful public dialog among the Government, interested businesses and experts regarding a clear-cut position on the part of the Ukrainian Government in negotiations on this Free Trade Agreement.

The "EU-Ukraine FTA: Analytical, methodological and informational support for negotiations" project is being implemented with funding from the Swedish International Development Agency (SIDA). The Centre's partners in this project are the Ministry of Economy, the Ministry of Foreign Affairs and the Secretariat of the Cabinet of Ministers. The goal project is to improve the process of economic and trade integration with the EU by providing analytical, methodological and informational support to Ukraine's central and local governments, the business community and the media. ICPS held the roundtable called "The impact and prospects of a Free Trade Agreement between Ukraine and the European Union" in Dnipropetrovsk on 26 October 2007.

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